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Original Article

Internal Control System and Audit Committee Influence on Financial Reporting Quality Mediated by Fraud Prevention in Manufacturing Companies Registered with ISSI in 2021-2024

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Abstract

The focus of this research is to investigate how the internal control system and audit committee impact the accuracy of financial reports, with fraud prevention acting as a mediator. Utilizing a quantitative methodology, data from annual reports of manufacturing companies listed in ISSI from 2021 to 2024 was analyzed through multiple linear regression and the sobel test. The findings indicated that both the Internal Control System and Audit Committee play a crucial role in preventing fraud. Fraud prevention also significantly affects the quality of financial statements. In addition, fraud Prevention has been shown to mediate the influence of both independent variables on the quality of financial statements. This research suggests that enhancing the internal control system and maximizing the effectiveness of the audit committee can lead to a substantial enhancement in the accuracy of financial statements for manufacturing companies listed on ISSI. By focusing on more efficient fraud prevention, these companies can significantly improve the quality of their financial reports. It is essential to strengthen both the internal control system and the audit committee at the same time to elevate the standard of financial statements, with fraud prevention playing a crucial role in companies listed on Issi from 2021 to 2024.

Keywords: Audit Committee, Financial Report Quality, Fraud Prevention, Internal Control System, Manufacturing Companies.

1. Introduction

Financial reports are documents that provide information on the financial status of a business or entity during a certain period. Typically, these documents are produced by businesses or organizations in order to give a summary of their financial accomplishments to different stakeholders like shareholders, staff, lenders, and other relevant individuals (Fitriana, 2024). The significance of financial statements cannot be overstated when it comes to the decision-making process for both internal and external stakeholders of a business. The accuracy and relevance of financial statements are crucial factors that play a key role in evaluating how well a company is performing. Economic development in indonesia today has grown rapidly, with very rapid economic changes become a trigger for companies to go public in Indonesia vulnerable to accounting crimes such as fraud (cheating). This crime refers to the act of manipulating financial data to cover losses by fictitiously raising revenue and to deceive investors and shareholders about the financial health of the company (Hutabarat & Renny, 2023).

The Association of Certified Fraud Examiners (ACFE) categorizes accounting fraud into three main categories, including manipulation of financial reports, theft of assets, and bribery. ACFE's latest report, which looks at cases from January 2022 to September 2023, includes 1,921 investigations across 138 countries, with losses totaling over $3.1 billion (ACFE, 2024). Fraud is frequently found in financial statements due to their susceptibility to manipulation in the way information is presented (Putra & Sari, 2023). Financial statements provide an overview of a company's financial status by examining its business activities and functions (Maghfira et al., 2022). The importance of financial statements requires business people to be able to provide data that is truly accurate and important without any indication of fraud so that those who need the report do not feel disadvantaged. The following figure shows the percentage of fraud globally according to the Association of Certified Fraud Examiners (ACFE) Report to the United Nations in 2024.

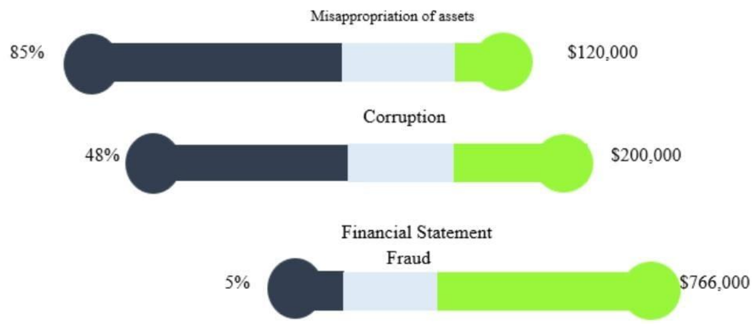

Figure 1. The Association of Certified Fraud Examiners (ACFE) Report to the United Nations 2024

From the image above it can be seen that the cases detected in the ACFE 2024 report asset abuse cases are the most common accounting for 85% of all cases, followed by corruption at 48%, and financial statement fraud at 5% but even though financial statement fraud is the smallest case the largest loss value is the Financial Statement case which is $766,000 compared (ACFE, 2024). Financial statement fraud is one of the most serious cases in the financial and business world.

As the phenomenon of accounting crime scandal that is happening today at PT Indofarma TBK (INAF) and its subsidiaries in this case highlights the failure in supervision and effective corporate governance. On May 20, 2024, the audit report (LHP) of the investigation by the Supreme Audit Board on the financial management of PT Indofarma Tbk and its subsidiaries was submitted to the Attorney General of the Republic of Indonesia. The report revealed significant irregularities that caused state losses of Rp371.8 billion. One of the main factors that led to this case is poor financial management in the company's internal and the existing supervision is not sufficient to catch the manipulation that occurs in the company.

Manipulation of financial statements is at the core of the PT Indofarma Tbk case, some of the manipulations revealed include fictitious income recording, asset value inflation, and concealment of financial liabilities. The fraud incident exposes the lack of effective internal oversight and inadequate corporate governance practices. Similar cases have been observed not only in PT Inofarma Tbk but also in other manufacturing companies within the food and beverage industry. In the results of the examination of the report, it was found that there were fraudulent statements, namely financial records that were different from the financial records used by financial auditors in examining the current annual financial statements. Investor confidence in the accuracy of financial statements has been shaken due to the increase in fraudulent cases. The cash flow statement plays a crucial role in supplying information about the company, assisting in evaluating ongoing operations and preparing for future investment and funding activities.

Fraud especially in terms of financial statements, occurs because of the encouragement and support of various parties. With high profits, it can provide a good image for the company, attracting various interested parties, especially investors and potential investors. A positive corporate image boost can encourage managers to use various strategies, including manipulating financial statements (Annisa et al., 2024). One of the main factors that cause cases of fraud in financial statements is poor financial management within the company, failure in internal supervision is one factor in the occurrence of financial statement fraud.

The internal control system is an essential and continuous process carried out by either management or staff to guarantee that organizational objectives are met through efficient and effective operations, trustworthy financial reporting, protection of government assets, and adherence to laws and regulations (Regulation No. 60 of 2008) which mandates all public sector organizations to adopt the government internal control system (SPIP). An internal control system is essential for identifying problems, managing and evaluating risks and correcting deficiencies in the financial system (Azri & Ruslim, 2023). Study by Nur et al. (2023) said that the internal control system persial affect financial quality. While research conducted by Kartika & Setiawati (2024) stated that the prevention of fraud is not impacted by having an effective internal control system and strong corporate governance measures in place.

The audit committee, set up by the board of commissioners, plays a crucial role in the fight against fraud in financial statements. Its primary responsibility is to monitor the company's operations and enhance performance, particularly in financial reporting (Trijayanti et al., 2021). This is the second attempt to prevent fraud. The audit Committee serves as the apex of the company's internal control and is responsible for providing professional opinions on the company's information and internal and external activities. The audit committee is tasked with enhancing the effectiveness of internal control systems and streamlining the checks and balances process. Research by Trijayanti et al. (2021) stated, that the audit committee is influential in preventing fraud, while Maisaroh & Nurhidayati (2021) stated that the audit committee has no influence in preventing fraud

The current study differs from the previous one in terms of the factors under investigation and the subjects involved. This study specifically looks at manufacturing companies listed on the Indonesian Sharia stock index (ISSI), which are known for adhering to Sharia principles. Previous studies focused primarily on the connection between the internal control system and the audit Committee in relation to the quality of financial statements. Other research also looked at how internal control systems and the audit Committee impact fraud prevention. Earlier research has indicated that both the internal control system and the audit committee are crucial in reducing fraud and can affect the accuracy of financial reports. However, some studies suggest that their impact may not be significant. From the explanation of the above explanation that the previous study was inconsistent, this inconsistency is an opportunity to further examine other factors that can strengthen the relationship between these variables with fraud prevention as a mediation variable.

In past research, the impact of internal control systems and audit committees on the accuracy of financial statements has been explored, as well as the role of fraud prevention, but there is still a research gap in comprehensively understanding how specific fraud prevention mechanisms mediate these relationships, especially in the context of manufacturing companies registered with ISSI. Some studies tend to examine these variables separately or with different mediating focuses. The unique aspect of this research is focused on examining how fraud prevention can act as a mediator between the internal control system and the audit Committee in influencing the accuracy of financial reports. Thus, this research contributes to the current body of knowledge by presenting more detailed empirical data and also sheds light on the significance of combining internal control systems and audit committees to prevent fraud and enhance financial reporting quality in the Islamic manufacturing industry.

2. Literature Review

2.1. Agency Theory

Agency theory was first proposed by Jensen and Meckeling in 1976. Which states that agency relationships occur when one or more people work together, such as principals and agents. Agency theory explains the contractual connection between the owner or investor (principal) and the management (agent), leading to conflicts of interest as a result of diverging interests and unequal information. In order to mitigate these dangers, the owner utilizes different monitoring tools like the Internal Control System (SPI) and having an Audit Committee (KA) to make sure that management is working in the best interest of the owner and minimizing agency expenses. SPI plays a role in directing managerial behavior to stay within the corridor, while KA performs the function of independent supervision of the financial reporting process. Fraud prevention efforts are the result of an effective surveillance system, because fraud tends to occur when internal controls are weak and information is asymmetrical. As a form of accountability, the quality of financial statements is an indicator of the agent's success in conveying accurate and reliable information to the principal (Purba, 2023).

2.2. Internal Control System

The internal control system is a crucial aspect of the ongoing efforts of leadership and staff to ensure the organization's goals are met through efficient and effective operations, trustworthy financial reporting, asset security, and adherence to laws (Siregar et al., 2024). Internal control refers to the set of organizational strategies and procedures implemented to safeguard assets, ensure the accuracy of information, enhance operational effectiveness, and promote adherence to company policies. This ensures that internal controls meet the expectations of all stakeholders, including shareholders and employees (Nainggolan, 2018).

Agency Theory explains the dynamic between owners and managers who may have conflicting interests, leading to potential disputes or imbalances in information. The internal control system is meant to reduce risks by ensuring that agents' actions align with the organization's goals. By establishing a strong internal control system, owners have the ability to oversee and manage manager actions to align with company interests, consequently minimizing the likelihood of fraud, misuse of power, and inefficiency in operations.

2.3. Audit Committee

The Audit Committee was created by the Board of Commissioners and the Board of Supervisors to evaluate the audits performed by both the Internal Audit Unit and external auditors. It offers suggestions for enhancing management control systems and supervises their execution (Arifin, 2018). The audit committee was created to support the board of commissioners in carrying out their duties of supervising the company's activities. The audit committee plays a crucial role in the corporate world by monitoring issues and shortcomings related to transparency and accountability in financial reporting within the company (Arif & Cheisiviyanny, 2023).

Agency Theory highlights potential conflicts of interest between management (agents) and company owners (principals) due to differing objectives and information asymmetry. In this context, the Audit Committee serves as an independent oversight mechanism that helps reduce such information imbalances. The Audit Committee is tasked with reviewing financial statements, overseeing the audit process, and ensuring compliance with regulations, so as to improve management transparency and accountability. Thus, the existence of the Audit Committee strengthens the control mechanism within the framework of Agency Theory, helping to protect the interests of owners from potential opportunistic actions of management.

2.4. Quality of Financial Statements

The financial statements' quality is determined by their accuracy in reflecting the company's activities, particularly in predicting cash flow, which serves as a key data point for investors. Financial Statement quality is a measure of the extent to which an entity's financial statements provide relevant, reliable, and easy-to-understand information for decision-making (Umiyati, 2017).

Agency Theory explains that the separation between the owner (principal) and manager (agent) can lead to conflicts of interest and information asymmetry. In this case, the quality of financial statements becomes an important tool to reduce the information imbalance between the two parties. Quality financial statements-relevant, reliable and comparable—are able to accurately reflect the financial condition of the company, thereby minimizing the opportunity for management to hide information or carry out manipulations. Therefore, the quality of financial statements is a reflection of the agent's efforts to maintain the confidence of the principal, as well as being a means of control and performance evaluation within the framework of Agency Theory.

2.5. Fraud Prevention

Preventing fraud involves getting rid of any chances of committing fraud by creating and executing risk management tactics, particularly focusing on fraud risk management, internal control, and transparent corporate governance practices. Preventing fraud is a cost-effective way to combat deceit. Avoiding deception is like preventing a sickness, as it is more beneficial to stop it before treating it (Nisa & Kuntadi, 2024).

In the perspective of Agency Theory, the relationship between the owner (principal) and Management (agent) is often prone to conflict of interest and information asymmetry, which can open up opportunities for fraud. Therefore, fraud prevention becomes an important mechanism to reduce the risk of opportunistic behavior from agents who may act contrary to the interests of the owner. This Prevention includes a system of supervision, internal audit, and internal control designed to limit management's wiggle room in committing fraud. In other words, fraud prevention efforts are in line with the principles of Agency Theory, which ensures that agents act within the best interests of the principal.

3. Methods

3.1. Research Type

In conducting this study, researchers used quantitative research methods in order to test the hypotheses that have been applied with the format of numbers or statistics. This research relies on secondary data as the primary source of information. Secondary data refers to information that is collected indirectly from the subject of study.

3.2. Population and Sample

The focus of this study comprises all the data provided by manufacturing companies listed with ISSI, detailing their internal control procedures and audit committee findings in financial reports from 2021 to 2024. The methodology employed in this study is purposive sampling, a method that selects a sample based on specific criteria relevant to the study's objectives. The selection of samples for this study was based on the factors listed below:

1) The sample consists of manufacturing companies listed in the Indonesian Sharia Stock Index (ISSI) for the period 2021–2024, which provide comprehensive data such as annual reports or audited financial statements.
2) Only companies meeting specific criteria were included, namely:
   a. Companies consistently listed in ISSI from 2021 to 2024, as accessed through www.idx.co.id/id.
   b. Businesses that release detailed annual reports and financial statements continuously during the examination period.
3) The manufacturing sector was chosen because it is particularly vulnerable to fraud risks, especially in relation to data manipulation and misreporting. This sector's complex operational structures increase the likelihood of misstatements in financial statements, thereby requiring a robust internal control system to ensure the accuracy and integrity of reported information.

3.3. Definition and Operational Variables

The following table presents the operational definitions of the variables used in this study, including their indicators, measurement scales, and data sources.

Table 1. Operational Definition of Variables

Variable	Indicator	Measurement	Scale
Quality of Financial Statements	a. Earnings quality b. Asset turnover	$Quality = \frac{Operating\ Cashflow}{Net\ Income}$	Interval
Internal Control System	**Control Environment** a. Show dedication to honesty and principles b. Demonstrate independence and carry out supervisory responsibilities c. Build a framework, establish control, and assign obligations d. Demonstrate a commitment to attracting, developing and retaining competent staff e. Enforcing accountability **Risk Assessment** a. Determining appropriate and specific goals b. Recognize and evaluate potential hazards c. Evaluate the likelihood of deceitful behavior d. Acknowledge and scrutinize important modifications **Control Activities** a. Choose and implement control measures that aim to minimize potential risks b. Implement standardized controls for technology systems c. Establish controls based on thorough policies and procedures **Information and communication** a. Using relevant and high-quality information b. Communicate internally to support control	$SPI = \frac{\sum \text{Score Indicator}}{Number\ of\ Indicators} \times 100\%$	Interval

Variable	Indicator	Measurement	Scale
	c. Communicate externally d. Monitoring e. Carry out continuous and/or separate evaluations f. Assess and communicate areas for improvement.		
Audit Committee	a. Number of audit committee members b. Proportion of independent members c. Frequency of annual meetings d. Possession of accounting/ finance competency	$KA\ Index = \dfrac{(\frac{KA(\%)}{100} + \frac{\text{Frequency of Meeting}}{20} + \frac{Competence\ Members}{3})}{3}$	Interval
Fraud Prevention	a. The anti-fraud policy b. Statement of management's commitment to fraud prevention c. Whistleblowing system d. Separation of functions & review of computer systems e. Manual control and clear division of tasks f. Training or socialization of anti-fraud to employees g. Periodic evaluation of fraud-prone areas h. Reporting fraud cases found and followed up i. The existence of a mechanism for reporting suspicious activity by employees	$Index\ PF = \dfrac{Total\ Score\ Indicator}{Total\ Indicator}$	Interval

3.4. Data Analysis Techniques

In this study the analysis of funds used is a descriptive statistical analysis used to analyze the dependent variables, independent variables, and mediation variables used. Descriptive statistics is one of the relevant statistical approaches to collecting and presenting useful data. By providing useful information, it is expected that readers or users can read and utilize data more easily.

4. Results and Discussion

4.1. Research Results

4.1.1. Descriptive Statistical Analysis

Table 2. Results of Descriptive Statistical Analysis

	N	Minimum	Maximum	Mean	Std. Deviation
Internal Control System	60	0.7647	0.9882	0.923887	0.9238
Audit Committe	60	0.2888	16.666	0.738643	0.7386
Quality of Financial Statements	60	0.0507	87.5510	14.729312	14.7293
Fraud Prevention	60	0.2222	0.8889	0.692592	0.6926
Valid N (listwise)	60				

Source: SPSS processed Data, 2025

The analysis of descriptive statistics reveals that variable X1 ranges from 0.7647 to 0.9882, with an average of 0.9238. In contrast, variable X2 shows a range from 0.2888 to 16.666, having a mean of 0.7386. As for variable Y, it has a range from 0.0507 to 14.7293, also having an average of 14.7293. On the other hand, variable M ranges from 0.2222 to 0.8889, with an average of 0.6926.

4.1.2. Multicollinearity Test

Table 3. X1 and X2 Against Mediation

Coefficients[a]

Model		Collinearity Statistics Tolerance	VIF
1	Internal Control System	0.993	1.007
	Audit Committe	0.993	1.007

a. Dependent Variable: Fraud Prevention

Source: SPSS processed Data, 2025

The examination of multicollinearity between variables X1, X2, and the mediator variable (M) demonstrates that the tolerance values exceed 0.1, while the variance inflation factor (VIF) values are under 10. Therefore, it can be deduced that there is no problem with multicollinearity when it comes to the independent variables related to the mediator variable.

Table 4. X1, X2, and M Against Y

Model		Collinearity Statistics Tolerance	VIF
1	Internal Control System	0.929	1.076
	Audit Committe	0.993	1.007
	Fraud Prevention	0.936	1.069

a. Dependent Variable: Unstandardized Residual

Source: SPSS processed Data, 2025

The test results for multicollinearity on variables X1, X2, and M in relation to the dependent variable (Y) indicate that the tolerance values are higher than 0.1 and the VIF values are lower than 10, indicating that there is no indication of multicollinearity among the predictor variables in this model.

4.1.3. Heteroscedasticity Test

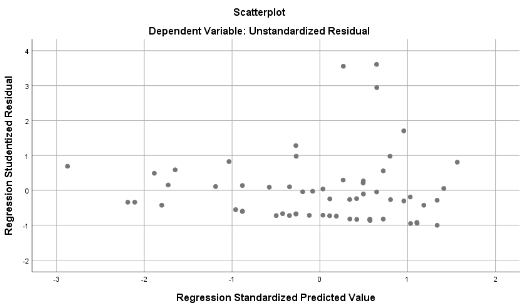

Figure 2. Scatter Plot Graph
Source: SPSS processed Data, 2025

According to the findings from the Scatterplot method used to test heteroscedasticity, it was observed that the points in the graph do not exhibit a specific arrangement or distribution, suggesting the absence of heteroscedasticity symptoms.

Table 5. Heteroscedasticity test results

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	6.172	59.202		.104	.917
	Internal Control System	-23.691	65.908	-.049	-.359	.721
	Audit Committe	-.026	1.236	-.003	-.021	.983
	Fraud Prevention	22.719	16.026	.192	1.418	.162

a. Dependent Variable: Unstandardized Residual

Source: SPSS processed Data, 2025

Heteroscedasticity test results of variables x1, x2, m against y does not occur heteroscedasticity problems because the GIS value >0.05 .

4.1.4. Normality Test

Table 6. Normality Test X1 and X2 Against Mediation

One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		60
Normal Parameters[a,b]	Mean	.000000
	Std. Deviation	.1612058
Most Extreme Differences	Absolute	.105
	Positive	.067
	Negative	-.105
Test Statistic		.105
Asymp. Sig. (2-tailed)		.100[c]

a. Test distribution is Normal.
b. Calculated from data.
c. Lilliefors Significance Correction.

Source: SPSS processed Data, 2025

The Kolmogorov-Smirnov test conducted showed that the Asymmp. Sig (2-Tailed) value was above 0.05, suggesting that the data in this study may adhere to a normal distribution.

Table 7. Normality Test X1, X2, and M against Y

One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		60
Normal Parameters[a,b]	Mean	.0000000
	Std. Deviation	.61832042
Most Extreme Differences	Absolute	.114
	Positive	.075
	Negative	-.114
Test Statistic		.114
Asymp. Sig. (2-tailed)		.052[c]

a. Test distribution is Normal.
b. Calculated from data.
c. Lilliefors Significance Correction.

Source: SPSS processed Data, 2025

The researchers utilized the Kolmogorov-Smirnov test to examine the distribution of variable y. An Asymmp. Sig (2-Tailed) value greater than 0.05 indicated that the data in the study could potentially conform to a normal distribution.

4.1.5. Hypothesis Test

1) Multiple Linear Regression Analysis

Table 8. X1 and X2 against Y

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	-1.276	.536		-2.382	.021
	Internal Control System	2.088	.565	.748	3.696	.000
	Audit Committe	.008	.003	.475	2.349	.022

a. Dependent Variable: Fraud Prevention

Source: SPSS processed Data, 2025

a. When both Internal Control System (SPI) and Audit Committee (KA) are equal to 0, the predicted value of Fraud Prevention is -1.276.
b. An increase of 1 unit in SPI is associated with an increase of 2.088 units in Fraud Prevention, assuming the Audit Committee (KA) remains constant. This indicates that SPI has a positive and significant effect on Fraud Prevention.
c. If KA increases by 1 unit, there will be a corresponding increase of 0.008 units in Fraud Prevention, as long as SPI does not change. This indicates that KA plays a crucial role in influencing Fraud Prevention.

Table 9. Hypothesis test results X1, X2, and M against Y

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	-8.408	.855		-9.829	.000
	Internal Control System	8.801	.958	.576	9.187	.000
	Audit Committe	-.036	.005	-.400	-6.786	.000
	Fraud Prevention	.618	.202	.113	3.064	.003

a. Dependent Variable: Quality of Financial Statements

Source: SPSS processed Data, 2025

a. The SPI has a beneficial impact on financial statement quality, demonstrating that robust internal control measures enhance the overall quality of financial reporting.
b. The Audit Committee (KA) has been found to have a detrimental impact on the accuracy of financial statements. This implies that the audit committee, in specific situations, may not enhance financial reporting quality and could even impede it.
c. Fraud prevention is essential for ensuring the accuracy and dependability of financial statements. It is evident that the company's ability to prevent fraud directly affects the reliability of the financial records produced.

2) Sobel Formula

$$z = \frac{ab}{\sqrt{(b^2 SE_a^2) + (a^2 SE_b^2)}} \qquad Z = \frac{2.088 \cdot 0.618}{\sqrt{(0.618)^2 \cdot (0.565)^2 + (2.088)^2 \cdot (0.202)^2}}$$

$$\begin{aligned} Z &= \frac{2.088 \cdot 0.618}{\sqrt{(0.618)^2 \cdot (0.565)^2 + (2.088)^2 \cdot (0.202)^2}} \\ &= \frac{1.289}{\sqrt{0.3819 \cdot 0.3192 + 4.361 \cdot 0.0408}} \\ &= \frac{1.289}{\sqrt{0.1219 + 0.178}} \\ &= \frac{1.289}{\sqrt{0.2999}} \\ &= \frac{1.289}{0.5477} \\ &= 2.353 \end{aligned}$$

The Sobel test indicates that the Z-value of 2.353 surpasses the critical value of 1.96 with a 95% confidence level. This suggests that the mediating effect is statistically significant, implying that Fraud Prevention has a significant impact on the relationship between the independent variables (SPI and KA) and the dependent variable (Quality of Financial Statements).

$$z = \frac{ab}{\sqrt{(b^2 SE_a^2) + (a^2 SE_b^2)}} \qquad Z = \frac{0.008 \cdot 0.618}{\sqrt{(0.618)^2 \cdot (0.003)^2 + (0.008)^2 \cdot (0.202)^2}}$$

$$\begin{aligned} Z &= \frac{0.004944}{\sqrt{0.000003437 + 0.000002611}} \\ &= \frac{0.004944}{\sqrt{0.000006048}} \\ &= \frac{0.004944}{0.002459} \approx 2.011 \end{aligned}$$

The Z-score has an absolute value of 2.01, surpassing the critical value of 1.96, making the outcome statistically significant with 95% confidence. This suggests that Fraud Prevention plays a significant role in mediating the connection between the Audit Committee and the accuracy of financial statements.

3) Hypothesis Test Results

a. Internal control system has a positive and significant effect on fraud prevention

The examination of the data showed that a powerful and favorable influence of the internal control system in preventing fraudulent behavior. This finding was backed by a regression coefficient of 2.088, indicating a notable level of significance at 0.000 (< 0.05) and a t-statistic of 3.696. Therefore, it could be concluded that businesses with strong internal control systems are more vigilant in their efforts to prevent fraud.

b. Audit Committee has a positive and significant effect on fraud prevention

The data analysis findings suggest that the audit committee plays a crucial role in preventing fraud, as demonstrated by a regression coefficient of 0.008, a significance level of 0.022 (< 0.05), and a t-statistic value of 2.349. Therefore, it can be inferred that the audit committee's active involvement and successful execution have a positive impact on enhancing the company's anti-fraud protocols.

c. Fraud Prevention has a positive and significant effect on the quality of financial statements

Based on the results of data analysis, the regression coefficient was found to be 0.618, suggesting a high level of significance at 0.003 (below 0.05) and a t-statistic of 3.064. This implies that as a company's anti-fraud measures become more efficient, the accuracy of its financial reports also improves.

d. Internal control systems affect the quality of financial statements.

The findings suggest that a company's financial information is more reliable and of higher quality when an internal control system is effectively implemented, based on the regression coefficient of 8.801, a statistically significant p-value of 0.000, and a t-statistic of 9.187.

e. Audit Committee negative and significant effect on the quality of financial statements

The data analysis results reveal a regression coefficient of -0.036, demonstrating a strong correlation with a value of 0.000 (less than 0.05) and a t-statistic of -6.786. This suggests that greater audit committee-related factors are linked to lower quality financial statements.

f. Fraud prevention significantly mediates the relationship between the Internal Control System and the Audit Committee on the quality of financial statements

The data processing findings reveal Z-values of 2.353 for the Internal Control System and 2.01 for the Audit Committee, surpassing the critical value of 1.96. Preventing fraud is essential in impacting the relationship between the internal control system and the audit committee, ultimately affecting the accuracy of financial reports. Additionally, it suggests that the impact of both variables on financial statement quality is seen not only through direct factors but also indirectly through fraud prevention.

4.2. Discussion

4.2.1. Influence of Internal Control System on Fraud Prevention

Based on the results of the examination, it was clear that the internal control system effectively prevented fraud. The regression coefficient was determined to be 2,088, indicating a significant impact at a level below 0.05. Furthermore, the T-statistics of 3,696 indicated that as the internal control system becomes more efficient, the effectiveness of fraud prevention within the organization also increases.

Creating a strong internal control system that includes components such as the control environment, risk assessment, control activities, information and communication, and monitoring can significantly reduce the chances of fraudulent behavior. With clear procedures, adequate separation of duties, transaction authorization, and ongoing supervision, the risk of fraud detection will increase, while suppressing the intention of the perpetrator to commit unethical acts. Therefore, manufacturing companies in ISSI need to continue to strengthen and evaluate their internal control systems as a key strategy in minimizing losses due to fraud.

Agency theory underscores the necessity of establishing internal control mechanisms that synchronize the goals of managers with those of owners in order to reduce the potential for misconduct such as fraudulent behavior. In the context of manufacturing companies registered with ISSI, research has proven that having a strong internal control system can greatly reduce the risk of fraud occurring. This happens because a strong internal control system creates a supervisory, accountability, and separation of duties mechanism that can detect, prevent, and minimize the chance of fraud, in line with the principles of agency theory in managing risk and ensuring the integrity of the company's operations.

The findings align with studies by Suwarsa & Sianipar (2024) and St.Ramlah et al. (2023). A strong internal control system is essential for enhancing fraud detection and preventing fraudulent activities within the company. This outcome aligns with the agency theory, which suggests that effective monitoring can diminish deceitful behavior by executives.

4.2.2. Influence of Audit Committee on Fraud Prevention

The results of the study suggested that the Audit Committee has a significant and beneficial effect on reducing fraud, as shown by a regression coefficient of 0.008, a significance level of 0.022 (below 0.05), and a T-statistic of 2.349. The existence of an effective Audit committee, with members who are independent, have sufficient expertise, and are active in supervision, can improve the quality of corporate governance. They are responsible for monitoring the financial reporting process, assessing internal control systems, and guaranteeing adherence to relevant regulations. This strict supervision directly minimizes the chance of fraud, because potential anomalies can be identified and avoided more readily, leading to a more open and responsible operational setting for Sharia-compliant manufacturing businesses.

Based on the agency theory, the Audit Committee plays a crucial role in mitigating conflicts of interest between management (agents) and shareholders (principals), thus making a valuable impact on preventing fraud, having an effective and meaningful influence. When an Audit Committee is both impartial and skilled, it promotes closer monitoring of the organization's financial and operational disclosures. This effectively reduces information asymmetry and opportunities for management to take opportunistic actions, including fraud, due to a robust check and balance mechanism. Empirical studies on Issi-listed manufacturing companies consistently show that a well-functioning Audit Committee substantially improves transparency, accountability, and corporate governance, ultimately minimizing the risk of fraud.

The findings align with studies conducted by Trijayanti et al. (2021), Sakinah et al. (2023) and Mardani et al. (2020) which stated that having a proactive and autonomous audit committee enhances the monitoring framework of the organization. According to agency theory, the audit committee serves as a key mechanism for controlling and overseeing the behavior of managers who act on behalf of the company.

4.2.3. The Effect of Fraud Prevention on the Quality of Financial Statements

The analysis revealed that enhancing measures to prevent fraud leads to a notable improvement in the accuracy of financial reports, as evidenced by a regression coefficient of 0.618, a significance level of 0.003 (which is less than the threshold of 0.05), and a T-statistics value of 3.064. This demonstrates that a more robust fraud prevention strategy correlates with higher quality financial statements for the company.

Studies often show that the quality of financial statements can be greatly improved by implementing reliable fraud prevention measures like robust internal controls, top-notch independent audits, and good corporate governance practices. This is in line with agency theory, where fraud prevention plays a role in minimizing opportunistic behavior of managers (agents) that can harm the interests of shareholders (principals), so that the information presented in financial statements becomes more reliable, relevant, and free from material misstatements. Thus, efforts to prevent fraud strongly will decrease information imbalance and enhance the trust of investors in the financial records of the company.

The findings align with previous studies by Tumpal (2020) and Noholo (2021) which noted that preventing accounting fraud greatly impacts the accuracy of financial statements. According to the agency theory, quality financial statements are those that demonstrate accountability and transparency.

4.2.4. Influence of Internal Control System on the Quality of Financial Statements

Based on the examination conducted, it is evident that the effectiveness of the internal control system has a notable impact on the accuracy and reliability of financial reporting as reflected on the regression coefficient value of 8.801, significance 0.000 < 0.05, t-statistic 9.187, indicating that a strong internal control system supports the formation of relevant, reliable, and transparent financial statements.

Within the framework of agency theory, an effective internal control system has a crucial role in aligning the interests of the principal (owner/investor) and agent (management), thereby reducing the potential for opportunistic behavior of agents that can harm the principal. Adequate internal controls, including internal oversight, separation of duties, and clear authorization procedures, will minimize errors, misappropriation of assets, and fraud, which in turn increases the reliability, relevance, and accuracy of information presented in financial statements. Thus, the higher quality of financial statements provides a more reliable basis for investors to make informed decisions and reduces information asymmetry between management and owners. The findings align with studies conducted by Mulyati et al. (2019), Fitriani et al. (2024), and Siregar et al. (2024) which denoted that enhancing the quality of the company's financial statements is possible through the implementation of a strong internal control system.

4.2.5. Influence of Audit Committee on the Quality of Financial Statements

The results of the study showed that the financial statement quality is influenced negatively by the audit committee, with a statistically significant regression coefficient of -0.036. The significance level of 0.000, which is less than 0.005, further reinforces this conclusion. Additionally, the t-statistics of -6.786 suggest that while the committee is performing its supervisory role, there is still room for improvement in enhancing financial statement quality through its actions.

The agency theory proposes that there is a noteworthy and adverse effect of the audit Committee on the financial statement accuracy of manufacturing firms affiliated with ISSI, which can be examined in diverse manners. One reason is the potential capture or co-operation of audit committee members by management. Although the audit committee is expected to act independently as a supervisor of management, pressure or self-interest may cause them to fail in effectively performing the supervisory role. When the audit committee is unable to challenge management decisions that could potentially harm the quality of financial statements, such as profit management practices or non-transparent disclosures, this will have a negative impact. In addition, information asymmetry between the audit Committee and management can also make matters worse.

Management can utilize detailed information about the company's activities to conceal or alter financial records without oversight from the audit committee. If the audit committee does not have sufficient capacity, expertise, or resources to independently dig up information and challenge the management narrative, their oversight becomes superficial and the financial statements potentially do not reflect the true state of affairs. This phenomenon, where governance mechanisms that are supposed to strengthen actually weaken, is in line with the premise of agency theory regarding the potential for failure in mitigating agency problems.

The findings align with studies conducted by Santi & Wafa (2024) which stated that the lack of effective implementation of the responsibilities of the audit committee, especially due to a shortage of qualified members in accounting and finance, is the main reason for the ineffectiveness of fraud prevention rather than the audit committee itself having a significant impact. This condition weakens the effectiveness of corporate supervision, so it still provides opportunities for fraud.

4.2.6. Fraud Prevention as a Mediation Variable

According to the findings of the sobel test, it seems that the presence of fraud prevention plays a role in influencing the connection between the internal control system and the audit Committee in terms of the financial statement's accuracy. The Z value of 2.353 for SPI and 2.01 for KA, which exceeds 1.96, suggests that the mediation is noteworthy.

Fraud prevention relies heavily on the interconnection between internal control systems and audit committees, which plays a vital role in mediating enhanced financial statement quality. This relationship is particularly significant in empirical research focusing on manufacturing firms included in the Indonesian Sharia Stock Index (ISSI). An effective internal control framework encompasses comprehensive policies and procedures specifically developed to protect organizational assets and ensure the precision of underlying accounting information. This systematic approach forms the foundation for reliable financial reporting and fraud mitigation strategies within Sharia-compliant manufacturing enterprises operating in the Indonesian capital market. However, the effectiveness of the internal control system will be more optimal with the role of independent supervision and evaluation of the audit committee. The audit committee is essential for upholding the accuracy of financial records, evaluating the efficiency of internal controls, and overseeing the financial reporting procedure. Their primary objective is to identify and rectify any flaws in the internal control mechanism in order to minimize the possibility of deceit and bolster the trustworthiness of financial statements among stakeholders.

Preventing fraud plays a vital role in upholding the accuracy of financial records. According to agency theory, this can be influenced by the presence of internal controls and audit committees. Agency theory emphasizes the existence of a conflict of interest between company owners and agents, in which managers may have an incentive to present inaccurate financial statements for personal gain. A strong internal control system serves as the primary supervisory mechanism, reducing the chances of fraud by establishing procedures and policies that limit unethical acts. The audit committee plays a crucial part in supervising internal controls and confirming the precision of financial statements as a separate entity. Thus, preventing fraud is not solely dependent on a strong internal control system, but is also enhanced by the vigilant oversight of the audit Committee. This combined effort helps enhance the accuracy of the financial reports of manufacturing companies affiliated with ISSI.

5. Conclusion

After examining the results of a study on the effects of internal control systems and audit committees on the accuracy of financial statements in manufacturing firms listed on the Indonesian Sharia stock index from 2021 to 2024, it was found that the internal control system plays a positive role in preventing fraud. Contrarily, the audit committee has a detrimental impact on the quality of financial statements. Furthermore, fraud prevention acts as a significant mediator between the internal control system and the audit committee in influencing financial statement quality.

Future research should consider expanding its scope to include various industries beyond manufacturing companies, encompassing other sectors listed on the Indonesian Sharia stock index (ISSI). This broader focus will offer a more comprehensive understanding of how internal control systems and audit committees affect financial statement quality with the mediation of fraud prevention. Researchers may also explore the inclusion of additional variables such as information technology, corporate ethics, or external auditor quality to investigate other factors that impact the relationship between variables and enhance comprehension of financial statement quality and fraud prevention. Additionally, researchers can extend the research period to observe long-term trends and their effects on the financial stability of companies.

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